

Discussion on Application of Substance over Form Principle in Accounting Practice

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Abstract: With the deepening of reform and opening up in our country, the organizational form of enterprises presents diversified characteristics. Besides, the vigorous development of market economy makes the economic business of enterprises increasingly complex. This puts forward higher requirements for accounting and information disclosure of enterprises. If in practice, only according to the legal form or artificial form of transactions or events which some of them do not reflect their economic essence and economic reality, it will not be helpful or even mislead the decision-making of accounting information users. In order to effectively standardize the authenticity and reliability of accounting behavior and accurately reflect the daily real business situation of enterprises, Substance over Form Principle plays an increasingly important role. This paper focuses on the application of substance over form in accounting practice, points out some problems and puts forward some suggestions.

1. Analysis of substance over form

1.1 Summary

In the Framework for Preparing Financial Statements published by IASB, substance over form is one of the quality characteristics of financial statements. It is pointed out that substance is more important than form, which means: "If information wants to truthfully reflect the transactions or other matters it intends to reflect, it must be accounted for and reflected according to its substance and economic reality, not just according to their legal form."

Article 16 of Accounting Standards for Enterprises stipulates that enterprises should not only take the legal form of transactions or events as the basis, but also make accounting confirmation, measurement and reporting according to the economic essence of transactions or events. These clearly point out that the accounting information of enterprises should not only focus on the superficial form, but also reflect the economic essence of the transaction content. When the legal form and economic essence of enterprise affairs conflict, accounting information should be inclined to the real realization of economic essence, and accounted for and reflected on this basis. In short, the essence is the ultimate goal, while the form is only the means to achieve the goal.

1.2 Significance

1.2.1 Providing useful information

There are two main opinions about accounting objectives. One is the useful view of decision-making, that is, to provide information users with useful decision-making information. The principle of substance over form plays a supplementary and perfect role in the application of the existing accounting principles in our country at the present stage. It can effectively show the real and perfect confirmation and measurement of enterprise accounting elements, and improve the

reliability and accuracy of accounting information. In this way, we can solve all kinds of complex factors and unnecessary negative effects of enterprise organizational form.

1.2.2 Perfecting Accounting System

Accrual basis is the basis of accounting, which can be optimized by the principle of substance over form. They are not unified and contradictory. They are mutually reinforcing. At the same time, the principle of substance over form makes a series of supplements to the principle of enterprise consistency. The principle of enterprise consistency also requires that the same or similar transactions or events occur in the enterprise. It should adopt a consistent accounting policy and not be changed at will. However, specific analysis of specific issues, if the accounting policy changes can provide more reliable, more relevant accounting information, accounting policy can be changed.

2. Application of substance over form in accounting practice

2.1 Recognition

The confirmation of accounting elements requires three conditions at the same time:

- (1) Complying with the definition of accounting elements;
- (2) Relevant economic interests are likely to flow into or out of enterprises;
- (3) The amount related to the economic interest can be reliably measured.

Taking assets as an example, assets refer to resources formed by past transactions or events, owned or controlled by enterprises and expected to bring economic benefits to enterprises. This definition embodies the characteristics of the principle that substance is more important than form in two aspects: first, the recognition of assets is not only whether they are owned by enterprises in law, but also whether they are controlled by enterprises in economic essence, such as financial lease. Although enterprises do not own their ownership in legal form, the lease period stipulated in the lease contract is quite long, which is close to the capital. The leasing enterprise has the option to purchase the assets first at the end of the lease period; the leasing enterprise has the right to control the assets and benefit from them during the lease period, while the lessee also bears the related costs and risks arising from the property. Therefore, combined with the principle that substance is more important than form, enterprises can control the future economic benefits created by financing and renting assets, which is the assets of enterprises; secondly, the economic essence of assets is expected to bring economic benefits to enterprises. Therefore, the enterprise excludes the assets that cannot bring economic benefits to the enterprise, so the expired raw materials, old goods and equipment that cannot be liquidated, etc. owned by the enterprise do not meet the conditions for asset recognition, and cannot be re-recognized as the assets of the enterprise.

Income criteria put forward that when selling goods, enterprises should clarify the essence of economic business, and analyze the risk and reward transfer contained in ownership. Non-monetary assets exchange without commercial substance should not recognize income at any time. Income should not be recognized in non-monetary asset exchanges between enterprises wishing to operate and for the convenience of sales by customers or potential customers (for example, oil exchanges between two oil companies in order to meet the needs of customers in different locations in a timely manner).

2.2 Measurement

Accounting measurement is a process in which money is the main unit of measurement, accounting elements that meet the requirements of confirmation are registered and reported in the financial statements to determine the amount of money. On the one hand, when inflating, enterprises should convert nominal monetary units into general purchasing power monetary units according to prudence and substance over form.

On the other hand, in the long-term equity investment, judging whether an enterprise should adopt the cost method or equity method for measurement also reflects the substance over form.

The long-term equity investment should be accounted for by equity method, and the long-term equity investment controlled by the investee should be accounted for by cost method. For example, company A owns 20% of company B. If viewed by voting rights, it does not belong to the controlling shareholder, but company A actually has a significant impact on company B (for example, company A holds the personnel rights of company B according to the agreement or company A has dispatched personnel on the board of directors of company B). According to Article 9 of Accounting Standards for Enterprises No.2, Long-term Equity Investment, Enterprises Investors should use equity method to calculate long-term and stable equity investment in enterprises.

2.3 Reporting

The purpose of financial accounting is to help users make relevant decisions by providing useful information to users of external accounting information. Financial report is the bridge between enterprise management and external information users, and the final result of financial accounting confirmation and measurement. When an enterprise determines the scope of consolidated financial statements, it shall determine them on the basis of control. In order to achieve control, investors must have the following basic elements at the same time: first, they enjoy variable returns because they are involved in the investee; second, they have the power to the investee, and have the ability to use the power to influence the amount of returns of the investee. In practical work, when judging whether the investor can control the investee, the investor should consider all relevant facts and circumstances comprehensively to judge whether the two elements of control are satisfied at the same time. If company A has a significant impact on company B, it can control the company's operation and decision-making. Even if the voting power of company A to company B does not reach 50%, it should be included in the consolidated statement. On the contrary, if company A owns more than half of company B's equity but does not get the actual control right, it cannot be included in the consolidated statement. This judgment process embodies the substance over form principle.

3. Problems of substance over form

The principle of substance over form is intended to truly reflect the financial situation and operating results of enterprises, but it is easy to be abused or evaded in the application of enterprises at present. Even, it is obviously unreasonable for some enterprises to use substance as a shield when they are found out accounting errors. It can be seen that over-emphasis on substance rather than form will affect the reliability and authenticity of accounting information. The principle of substance over form provides accountants with space for independent research and professional judgment, which requires their comprehensive literacy and professional level to continue to improve. However, at present, the professional quality of Accountants in China is uneven, and there may be subjective assumptions or artificial manipulation of profits.

4. Suggestions of substance over form

4.1 Improve the professional judgment and moral level of accountants

Enterprises should take effective measures to strengthen the re-education of accountants and improve their professional knowledge and professional ethics. At the same time, accountants should always maintain professional sensitivity and flexible thinking, keep pace with the times, learn new standards and systems, make correct judgments on the economic business of enterprises, and avoid subjective assumptions. In addition, accountants should also strictly abide by professional ethics and avoid accounting fraud and artificial manipulation of profit behavior.

4.2 Strengthen accounting supervision

Accounting supervision is the guarantee of accounting. In order to ensure the rational application of the principle of substance over formality, enterprises should strengthen management and

supervision, and severely penalize corporate accounting fraud. Increase the risk of accounting fraud, thereby reducing the possibility of companies providing false information. At the same time, the supervision of enterprises by the relevant departments should be further improved, and the penalties for violations of enterprises should be increased.

5. Conclusion

The substance over form principle as an important information quality requirement is reflected in all aspects of accounting practice. However, some problems have also arisen with its widespread application. Enterprises should pay attention to cultivating the comprehensive quality of accounting personnel, and apply the substance to the formal principle in a reasonable and appropriate manner. Substantive over formal principles will play an increasingly important role in accounting practice and help provide more reliable accounting information.

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